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How the Government Budgets for Student Loans

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Direct Versus Guaranteed Student Loans

- The Federal Direct Student Loan Program
 - As of 2010, all new federal student loans are in the direct loan program.
 - The federal government serves as the lender by providing the capital for loans.
 - Loans are still serviced by private-sector companies.

- The Federal Guaranteed Student Loan Program
 - Before 2010, schools could choose between the direct and guaranteed loan programs.
 - Loans were made by banks and other financial institutions, and the federal government insured those loans against loss and paid a portion of the borrowers' interest.
 - Terms for borrowers were nearly identical in the two programs.
 - No new guaranteed loans are being issued, but borrowers are still repaying loans that originated before 2010.

Types of Student Loans

- **Subsidized loans** are need-based loans for undergraduate students. No interest accrues while the borrower is enrolled in school or during other deferment periods. Borrowing is limited by class level and dependency status.
- **Unsubsidized loans** are non-need-based loans for undergraduate and graduate students. Interest accrues at all times. Borrowing is limited by class level and dependency status.
- **PLUS loans** are non-need-based loans for graduate students and parents of dependent undergraduates. Borrowing is limited only by the cost of attendance.

Cash Versus Accrual Accounting

- The Federal Credit Reform Act of 1990 stipulated that the costs of all federal direct and guaranteed loans must be recorded on an accrual, or credit-reform, basis rather than on a cash basis.
- In **cash accounting**, costs are recorded when payments are made, and revenues are recorded when receipts are collected by the federal government.
- In **accrual accounting**, costs are recorded when goods are received or services are performed rather than when they are paid for, and revenue is recorded when it is earned rather than when actual payments are received.

How CBO Estimates the Costs of Federal Student Loans on a Credit-Reform Basis

- The estimated net cost of a loan to the federal government is shown in the year the loan is originated.
- To determine that cost, CBO estimates all future cash flows for a cohort of loans originated in a specific year.
 - Under a process called discounting, the value of future cash flows is expressed in terms of today's dollars.
 - Credit-reform rules require the use of the interest rate on Treasury securities with the same terms of maturity (the rate at which the government borrows money) for discounting.
- Exception: Costs related to administering the student loan programs are shown on a cash basis rather than an accrual basis.

Example: Estimate of the Federal Cost of a Loan on a Credit-Reform Basis

(Dollars)

2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 Total

Nominal Cash Flows

Disbursement	3,000	0	0	0	0	0	0	0	0	0	0	0	3,000
Repayment, Principal	0	0	-243	-254	-266	-278	-291	-305	-319	-334	-350	-360	-3,000
Repayment, Interest	<u>0</u>	<u>0</u>	<u>-133</u>	<u>-122</u>	<u>-110</u>	<u>-97</u>	<u>-84</u>	<u>-70</u>	<u>-56</u>	<u>-41</u>	<u>-26</u>	<u>-9</u>	<u>-748</u>
Total	3,000	0	-375	-375	-375	-375	-375	-375	-375	-375	-375	-369	-748

Discounted Cash Flows

Disbursement	3,000	0	0	0	0	0	0	0	0	0	0	0	3,000
Repayment, Principal	0	0	-236	-242	-247	-251	-254	-258	-262	-265	-269	-267	-2,551
Repayment, Interest	<u>0</u>	<u>0</u>	<u>-129</u>	<u>-116</u>	<u>-102</u>	<u>-88</u>	<u>-73</u>	<u>-60</u>	<u>-46</u>	<u>-33</u>	<u>-20</u>	<u>-7</u>	<u>-673</u>
Total	3,000	0	-366	-358	-348	-339	-328	-318	-308	-297	-288	-274	-224

Cost of this loan recorded in fiscal year 2018: -\$224

Subsidy rate: -7.47%

(The subsidy rate is the sum of discounted cash flows, -\$224, divided by the loan amount originated, \$3,000, and expressed as a percentage.)

Estimating the Costs of Student Loans on a Fair-Value Basis

- This procedure more fully accounts for the cost of nondiversifiable risk that the government takes on.
- The same estimated cash flows are used, but the discount rate applied to those cash flows is based on market prices rather than rates on Treasury securities.
- The discount rate is higher and the value of future repayments to the federal government is lower, which increases the estimated cost of the direct loan program.

CBO's June 2017 Supplemental Student Loan Data

www.cbo.gov/publication/51310

CBO's June 2017 Projections: Student Loan Totals

(Millions of dollars, by fiscal year)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2017-2027
Guaranteed Student Loans												
Budget Authority	10,265	-468	-426	-412	-363	-322	-263	-214	-176	-145	-119	7,357
Outlays	10,022	-683	-617	-581	-512	-452	-376	-312	-262	-220	-184	5,823
Direct Student Loans												
Budget Authority	24,749	-10,021	-7,908	-6,806	-6,233	-5,807	-5,907	-6,127	-6,350	-6,604	-6,846	-43,859
Outlays	23,810	-9,389	-7,718	-6,463	-5,806	-5,392	-5,334	-5,500	-5,701	-5,921	-6,144	-39,558
Student Aid Administration (Discretionary)¹												
Budget Authority	1,575	1,610	1,645	1,680	1,717	1,757	1,796	1,836	1,879	1,923	1,967	19,386
Outlays	1,535	1,584	1,623	1,658	1,694	1,732	1,771	1,811	1,852	1,895	1,939	19,095
Student Aid Administration (Mandatory)²												
Budget Authority	1,857	1,922	1,987	2,052	2,120	2,193	2,273	2,348	2,410	2,459	2,505	24,127
Outlays	1,689	1,906	1,971	2,035	2,102	2,175	2,253	2,329	2,395	2,446	2,494	23,795
Total Student Loans												
Budget Authority	38,446	-6,957	-4,703	-3,486	-2,759	-2,179	-2,101	-2,157	-2,236	-2,367	-2,493	7,010
Outlays	37,056	-6,582	-4,741	-3,351	-2,522	-1,937	-1,686	-1,672	-1,716	-1,799	-1,895	9,154

Components may not add up to totals because of rounding.

1. Projections of discretionary spending for administering student aid are based on an inflation of the budget authority provided in the most recent appropriations act rather than on an estimate of the future costs of administering the program. This total does not reflect any potential reductions in spending stemming from the across-the-board cut that is part of the final appropriations act.

2. Projections of mandatory spending for administering student aid are based on estimated future costs of administering federal loan programs

CBO's June 2017 Projections: Total Direct Loan Program

(By fiscal year, loan volume in millions of dollars)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Total All New Loans^a										
Net Annual Loan Volume	100,910	104,463	107,810	111,417	115,552	120,024	124,321	128,904	133,775	138,953
Subsidy Rate ^{b, c, d}	-8.90%	-6.82%	-5.71%	-5.07%	-4.57%	-4.48%	-4.48%	-4.48%	-4.49%	-4.48%
Subsidized Student Loans										
Net Annual Loan Volume	22,964	23,789	24,548	25,268	26,122	27,060	28,093	29,060	30,089	31,186
Subsidy Rate ^{b, c, d}	5.63%	7.78%	8.86%	9.52%	10.03%	10.13%	10.11%	10.10%	10.09%	10.08%
Unsubsidized Student Loans: Undergraduate										
Net Annual Loan Volume	24,071	24,864	25,593	26,293	27,141	28,089	29,147	30,150	31,233	32,403
Subsidy Rate ^{b, c, d}	-4.43%	-2.85%	-2.23%	-1.75%	-1.34%	-1.29%	-1.33%	-1.35%	-1.37%	-1.39%
Unsubsidized Student Loans: Graduate										
Net Annual Loan Volume	29,177	30,129	31,049	32,158	33,418	34,758	35,868	37,256	38,736	40,314
Subsidy Rate ^{b, c, d}	-12.05%	-9.45%	-7.78%	-6.93%	-6.29%	-6.16%	-6.21%	-6.22%	-6.25%	-6.26%
GradPLUS Student Loans										
Net Annual Loan Volume	10,653	11,231	11,804	12,456	13,174	13,932	14,602	15,389	16,218	17,091
Subsidy Rate ^{b, c, d}	-13.82%	-10.81%	-9.23%	-8.35%	-7.69%	-7.56%	-7.60%	-7.61%	-7.63%	-7.65%
Parent Loans										
Net Annual Loan Volume	14,044	14,450	14,816	15,242	15,697	16,186	16,612	17,050	17,499	17,960
Subsidy Rate ^{b, c, d}	-30.03%	-29.08%	-28.71%	-28.39%	-28.18%	-28.18%	-28.25%	-28.27%	-28.31%	-28.33%

Components may not add up to totals because of rounding.

a. Totals exclude consolidation loans stemming from loans issued prior to 2017.

b. The subsidy rate is the net present value of the future federal cash flows divided by the loan dollars disbursed to borrowers each year. For example, the 2018 federal cost associated with the \$100,910 million in new loan volume would be -\$8,981 million or -8.90% of the new loan volume [$\$100,910 \times -.0890 = -\$8,981$]. In other words, the federal

c. Subsidy rates do not include federal administrative costs associated with disbursing and servicing loans. Those administrative costs are included in the budget on a cash basis (see Table 3).

d. Subsidy rates were calculated using CBO's June 2017 interest rate forecast.